

Internal Revenue Service

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Date:
February 19, 2009

Legend

Taxpayer

State =

Board =

Trust =

Plan =

Dear :

This is in reply to your letter dated October 23, 2008 and subsequent correspondence, in which you request various rulings on behalf of Taxpayer with respect to Plan and Trust.

FACTS

Taxpayer is a body politic and corporate existing under the laws of State. As a body politic and corporate of State, Taxpayer is a political subdivision of State. Taxpayer is governed by Board.

Taxpayer adopted Plan as a means of providing health benefits to its eligible retirees. Taxpayer is authorized to amend or terminate Plan.

Under Plan, Taxpayer pays all or a portion of the premium for health insurance coverage for eligible retirees. Only eligible retirees receive benefits. Spouses, dependents or other beneficiaries are not eligible to receive Plan benefits.

Taxpayer represents that there are no pre-tax salary reduction elections under Plan. In addition, Taxpayer represents that Plan does not permit a cash-out of unused amounts or a conversion of sick or vacation days to retiree health benefits. Participants may not salary-reduce to pay for any benefit. Plan is funded solely with Taxpayer contributions.

Taxpayer created Trust to provide a vehicle for funding retiree benefits under Plan. The income of Trust consists solely of contributions from Taxpayer and investment income. Trust assets will be used to pay for Plan benefits and for the administration of Trust. Private interests do not participate in Trust. No part of Trust may be diverted to purposes other than the exclusive benefit of the participants and their beneficiaries. No part of the Trust's net earnings may inure to the benefit of any private person.

Taxpayer may terminate Trust at any time for any reason. Upon termination of Trust, the remaining assets of Trust will be used solely to provide health benefits to the participants of Plan and to satisfy other debts or liabilities of Trust. Any assets remaining in Trust after meeting the obligations of Plan and satisfying other liabilities of Trust would be transferred to Taxpayer.

LAW AND ANALYSIS

Section 115(1) of the Internal Revenue Code (Code) provides that gross income does not include income derived from any public utility or the exercise of any essential government function and accruing to a state or any political subdivision thereof.

In Rev. Rul. 77-261, 1977-2 C.B. 45, income from an investment fund, established under a written declaration of trust by a state, for the temporary investment of cash balances of the state and its participating political subdivisions, was excludable from gross income for federal income tax purposes under §115(1). The ruling indicated that the statutory exclusion was intended to extend not to the income of a state or municipality resulting from its own participation in activities, but rather to the income of a corporation or other entity engaged in the operation of public utilities or the performance of some governmental function that accrued to either a state or municipality. The ruling points out that it may be assumed that Congress did not desire in any way to restrict a state's participation in enterprises that might be useful in carrying out projects that are desirable from the standpoint of a state government and which are within the ambit of a sovereign to properly conduct.

In Rev. Rul. 90-74, 1990-2 C.B. 34, the Service determined that the income of an organization formed, funded, and operated by political subdivisions to pool various risks (casualty, public liability, workers' compensation, and employees' health) is excludable

from gross income under § 115 of the Code. In Rev. Rul. 90-74, private interests neither materially participate in the organization nor benefit more than incidentally from the organization.

Trust provides health benefits to retired employees of Taxpayer, a political subdivision of State. Providing health benefits to current and former employees constitutes the performance of an essential government function. Based upon Rev. Rul. 90-74 and Rev. Rul. 77-261, Trust performs an essential governmental function within the meaning of § 115(1) of the Code.

The income of Trust accrues to the Taxpayer. No private interests participate in or benefit from the operation of Trust. Any distribution of remaining funds in Trust to participating retirees upon the dissolution of the Trust satisfies an obligation the Taxpayer has assumed with respect to providing benefits to its employees. The benefit to the participating employees is incidental to the public benefit. See Rev. Rul. 90-74.

Section 61(a)(1) of the Code and §1.61-21(a)(3) of the Income Tax Regulations provide that, except as otherwise provided in subtitle A of the Code, gross income includes compensation for services, including fees, commissions, fringe benefits, and similar items.

Section 106(a) of the Code provides that gross income of an employee does not include employer-provided coverage under an accident or health plan.

Section 1.106-1(a) of the regulations provides that the gross income of an employee does not include contributions which his employer makes to an accident or health plan for compensation (through insurance or otherwise) to the employee for personal injuries or sickness incurred by him, his spouse, or his dependents, as defined in §152. The employer may contribute to an accident or health plan either by paying the premium (or a portion of the premium) on a policy of accident or health insurance covering one or more of his employees, or by contributing to a separate trust or fund (including a fund referred to in § 105(e)) which provides accident and health benefits directly or through insurance to one or more of his employees. However, if the insurance policy, trust or fund provides other benefits in addition to accident or health, §106 applies only to the portion of the contributions allocable to accident or health benefits.

Coverage provided under an accident and health plan to former employees is excludable from gross income under §106. See Rev. Rul. 62-199, 1962-2 C.B. 32; Rev. Rul. 82-196, 1982-2 C.B. 53.

Based on the information submitted and representations made, we conclude as follows:

- (1) The income of Trust is derived from the exercise of an essential governmental function and will accrue to a state or a political subdivision thereof for purposes

of § 115(1). Accordingly, Trust's income is excludable from gross income under § 115(1) of the Code.

- (2) Payments made from Trust which are used exclusively to pay for the accident or health coverage of retired employees are excludable from the gross income of retired employees under §106 of the Code.

No opinion is expressed concerning the Federal tax consequences of Plan or Trust under any other provision of the Code other than those specifically stated herein.

This ruling is directed only to the Taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Harry Beker
Chief, Health and Welfare Branch
Associate Counsel/Division Counsel
(Tax Exempt & Government Entities)